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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932

No. 779

CENTRAL KENTUCKY NATURAL GAS COMPANY,
Appellant,

v.

RAILROAD COMMISSION OF KENTUCKY, *et al.*,
Appellees.

REPLY BRIEF FOR APPELLANT

It is not easy to follow some of the reasoning, to discover the relevancy of much of the discussion and citation of authority, or to harmonize many of the contentions and observations contained in the brief submitted by appellees. A considerable portion of their brief is devoted to matters outside the record, and throughout contains many unjustified claims and unsupported statements and figures. Many of the arguments advanced are too fanciful for serious consideration.

The effort of appellees to support the trial court in what it said in its opinion about being requested to

determine a rate as of December 31, 1926, and in centering its argument upon an extremely narrow interpretation of what the court actually did, if successful, would defeat the very purpose and intent of the parties to this controversy and destroy the contract between them. In equity and good conscience the city should not be permitted to accomplish that end.

There is much more involved in this case than the mere determination of just and reasonable rates as of or for a date certain. The governing principles are of much broader scope, and whether based upon equitable rights or upon the very terms of the contract itself the goal is the same, namely, the determination of fair compensation (just to both parties) for the gas service rendered and received.

So much undeserved importance has been attached to specific dates rather than to a period of time that the real question here involved has perhaps become obscured; in fact, obliterated if the lower court's conclusions are permitted to stand. It is, and we say this with all due respect, occasioned by the attempt of the court to defend its result by the adoption of a wrong premise (the alleged request of the parties to determine a rate as of December 31, 1926) when in fact it sought to determine just compensation for services performed over the considerable period of time involved. What the court *says* it did or what *reason* it assigns therefor is not vital. The important thing is what it actually *did,* and was justified or required to do under the facts in this case.

The applicable law required the court to determine the compensation due the company under all the circumstances shown to have a bearing upon the question (and under average or normal conditions) notwithstanding it says the parties asked it to adopt a particular date. It did not in fact do what it says the parties asked to be done, and our complaint is that while it appears to have adopted the correct principle it failed to consider some of the operating cost factors essential to a correct determination of just compensation in the application of that principle.

COST OF GAS

We shall not discuss the matters dealt with in the city's brief in the order presented, but come first and directly to the main question of whether the cost of the Owsley County (Petroleum Exploration) gas should be considered in determining reasonable rates for the company's gas service.

The following facts are not in dispute:

1. This rate controversy arises under the Franchise Contract; also, Section 23 of that contract required the company to secure the Owsley County gas, and the company complied with this obligation which resulted in fixed annual expenses of $300,000.

2. Delivery of this gas began in November 1927, and by reason thereof the temporary rate of 60 cents went into effect on December 1, 1927.

3. The franchise contract provides for just and reasonable rates and the controversy from the beginning

has been over the fixation of such rates for the gas service rendered by the company under said contract.

4. In the trial of this case before the Commission, and before the Statutory Court on the same evidence, and at all times the city conceded that in determining reasonable rates for the company's gas service full allowance should be made for the cost of the Owsley County gas.

5. Under the pleadings the issue before the Statutory Court was the vadidity of the Commission rate for the full period to which it applied its rate, namely, from the contract date to the date of the Commission order.

6. The parties agreed that the court should determine the rate base as of December 31, 1926, and adopt that value for all purposes of this case.

7. Neither party made any request whatever that *income* be determined as of any particular date.

8. Under the issue presented by the pleadings the right to the impounded funds depended on the determination of reasonable rates making allowance in operating expenses for the cost of the Owsley County gas.

The only reference to income in the court's opinion is in connection with its discussion of the United Fuel contract and the city's contention with regard thereto. The court said:

> "That relationship did not exist prior to 1928 and inasmuch as we are asked to fix the rate base and determine the income as of December 31,

> 1926, * * * we should accept the contract price of gas purchased from United Fuel as part of the cost of operation" (R. 85).

The city does not contend that the court was in fact asked to determine the company's *income* as of December 31, 1926, or that its recital to that effect is anything more than its own conclusion as to the effect of the request of the parties to determine the *rate base* as of that date.

The city did contend that in determining the validity of the Commission rate the court should not allow in operating expenses the contract price for the United Fuel gas. The fact that this contention was made is inconsistent with any claim that the court had been requested to determine "income" as of December 31, 1926, and since the intercorporate relation did not arise until January, 1928 the city's argument proves beyond doubt that no such request was made.

The city's contention concerning the United Fuel gas also conclusively shows that it expected the court to make full allowance for the Owsley County gas because the intercorporate relation on which its contention was based arose *after* the cost of said gas began; and establishes with equal certainty that what was said by the parties with reference to the rate base was never for a moment considered by them as having the slightest bearing on the right of the company to be allowed the cost of the Owsley County gas in determining the validity of the Commission rate, or the reasonableness of any other rate for its gas service.

It would seem that the court below construed the request of the parties to determine the value of the property as of December 31, 1926, involved as a legal consequence a request to make all findings as of that date. The company insists that no such legal consequence followed from the request to determine the rate base as of December 31, 1926.

It is now apparent that the city, although it conceded prior to the court's opinion that full allowance should be made for the Owsley County gas in determining a reasonable rate for the appellant's gas service, would shelter under the construction which the court has attributed to the request of the parties relative to the rate base, and thus retain an advantage wholly unexpected and to which it is not entitled. The city having contracted for a particular service for which it agreed to pay, would now, after having secured the benefits of such service avoid paying for it.

While the city in its brief attempts to sustain the literal accuracy of the court's statement as to what was "asked" or "requested" by the parties, no defense is offered for the exclusion of the cost of the Owsley County gas as a matter of legal right.

If the court actually intended to exclude the cost of the Owsley County gas in its estimate of the probable results of the 50-cent rate, why did it include in its estimated net income of $144,574.00 for 1927 the amount of $47,485.34 actually paid for that gas delivered in December of that year? And if the court in concluding a 50-cent rate would be reasonable ac-

tually intended to exclude the cost of the Owsley County gas, why did it not explain or defend its action on that ground?

If the rejection of the company's estimate of return set forth in Exhibit No. 6 was at all influenced by the fact that this statement made full allowance for the cost of the Owsley County gas, why did not the court call attention to that fact and base its rejection of the estimate on that ground?

While it is stated in the opinion that the parties requested the court to fix the rate base as of December 31, 1926, and to determine income as of that date, *the court itself did neither.* It took the sale price as of January 1, 1928, and the net income arrived at by it under the temporary rate for the year 1927. The court, in its attempt to determine a just and reasonable rate under the franchise contract included *the cost of the Owsley County gas* for one month in 1927 which is all that was reflected in that year's business. This is the method contended for by appellant and for which it argued in its brief filed in the court below (from which counsel for the city have quoted in their brief filed here), the error consisting in not making allowance for the *full* annual cost of the Owsley County gas.

What did the court mean when it said it had been asked to determine income as of December 31, 1926? If the court meant literally that income should be ascertained as of that date, then it would have taken the actual results under the 50-cent rate for 1926. But the court specifically rejected that basis (1926 not being an average or normal year).

Did the court mean that it was asked to exclude from consideration anything occurring after December 31, 1926, which would affect net income even though specifically required by the contract? If so, such construction did clear violence to the actual position and manifest expectation of the parties since they were agreed that in determining income full allowance should be made for the cost of the Owsley County gas. Furthermore, the city was contending that allowance should not be made for the United Fuel gas on the basis of the contract price, and was justifying this contention upon the theory that the court should hold the United Fuel Gas Company bound to furnish appellant all the gas it needed at a lower price because of the corporate affiliation which did not arise until January, 1928.

Obviously the parties did not intend to abandon their long assumed positions, or contemplate that the request made relative to the valuation date should have such legal effect. That no such thought existed in the mind of counsel for the city is perfectly clear from the fact that they contended no allowance should be made for the United Fuel gas in excess of 12½ cents. The brief of the city filed here shows it is still contending for this position. Although the intercorporate relation did not arise until a year after December 31, 1926, the city was insisting it should be given effect *as of the franchise contract date.* Thus the city was urging that events occurring *after* the franchise contract date should be given full effect as of that date.

It is true that the court in rejecting the city's contention, regarding the United Fuel contract stated the intercorporate relation did not exist as of December 31, 1926, but the true ground of decision would have been and is that the intercorporate relation could have no effect on that contract regardless of the date when such relation began. That gas purchase contract was made at arm's length. It bears date of November 1, 1912, and provides that—

> "* * * this contract shall continue for the term of twenty years from its date and so long thereafter as the United Company produces gas in marketable quantities from its gas properties in West Virginia and Kentucky" (R. 242).

Let us assume the intercorporate relation had arisen *before* the date of the franchise contract, and that while the company, because of the added supply from the Petroleum Exploration, did not require from the United Fuel as much gas as before, yet it did need a large quantity from that company in order to supply its customers. Let us further assume, which is the fact as clearly appears from the record, that appellant could not nearly supply its markets without the United Fuel gas. The evidence shows that this source of supply had been the very backbone of the company's ability to render service since 1912, and that without such gas appellant would long since have been wholly unable to furnish natural gas to its Lexington consumers.

If by reason of the intercorporate relation the United Fuel had declined to furnish any more gas under the contract there would have been an instant and rightful protest on the part of the City of Lexington. Had the appellant acquiesced in such position and attempted to release the United Fuel from its contract obligation, thus surrendering this gas and reducing its ability to supply its demand, the courts would have given immediate relief and compelled specific performance of that contract.

But in compelling specific performance would the court enforce the contract as written and require the appellant to take the minimum amount stipulated and pay the contract price, or could the court have required the United Fuel to furnish appellant gas at such times and in such quantities as it might need and fix the price therefor at 12½ cents? The answer is obvious.

The appellant therefore contends that in rejecting the city's contention relative to the United Fuel contract, the court was right in assigning as a reason therefor that the contract was one made at arm's length but was clearly wrong in giving as a reason that it was asked to determine income as of December 31, 1926.

In support of its contention relative to the United Fuel contract the city cites the decision of this Court in Western Distributing Company v. Public Service Commission of the State of Kansas, 285 U. S. 119. The facts in that case are not parallel. An essential point of difference is that in the Western

Distributing Company case there was no continuing or enforceable contract which had not expired. In that opinion the Court said:

> "The current price is 40 cents per thousand cubic feet which is what was agreed to *under a day to day verbal contract.*"

It was by reason of the fact that there was no definite or fixed contract obligation that the Court supported the Kansas Commission in the position it took that the company should be required to justify the city gate price of 40 cents.

Counsel for the city have quoted a portion of the company's original brief in the court below in support of the court's statement that it was asked to determine the income as of December 31, 1926 (R. 85), and determine whether the rate established by the Commission afforded a reasonable return on said date, as against our contention that no such request was made.

We welcome the reference to the company's brief in the court below, and trust this Court will find time to read that brief in its entirety, and then determine whether the inference now sought to be placed on the quoted portion of that brief justifies in the remotest degree the conclusion sought to be drawn therefrom that the court was asked to determine the validity of the Commission rate as of December 31, 1926.

The portion of the brief which counsel for the city now quote was part of an argument beginning at page 53 under the heading

and was addressed particularly to the proposition that under the terms of the franchise contract, and by reason of the impounded funds which the parties had voluntarily brought in and placed *in custodia legis*, the question of just and reasonable rates was a judicial one, and that the court could properly determine what rates would be just and reasonable under the evidence submitted and apply same for the contract period and thus dispose of the impounded funds which had accrued.

As bearing on that question and also on the proper construction to be placed on the quoted portion of the company's brief we quote what was said at pages 55, 56 and 57 of that brief:

> "We therefore assume that the Court will specifically find, (a) the rate bases, (b) the rate of return, (c) allowance for amortization and depletion, extraordinary maintenance and contingencies, (d) the actual revenues under the forty and fifty-cent rates, (e) *the probable revenues and per cent return under the forty-five-cent rate,* (f) *the probable revenues and per cent return under the second, and perhaps also under the first schedule of rates and charges promulgated by the company,* (g) the right of the Company to promulgate a rate schedule including a service charge instead of a flat rate, (h) *whether the actual revenues under the experience rates have*

been sufficient, or whether the *probable revenues under the first* or second *schedules promulgated by the Company will be sufficient to yield an adequate return* on the total valuation as fixed by the Court.

Depending on the Court's actual findings on the foregoing points must be determined the character and scope of relief the Court should grant. The question of relief we desire to discuss on varying hypotheses, as follows:

1. Assuming the Court will find that the forty-five cent rate ordered by the Commission will not produce revenue sufficient to yield the rate of return as fixed by the Court, on the value of the property used and useful as fixed by the Court, it follows that the Court will adjudge the forty-five cent rate to be confiscatory, and grant a permanent injunction against the enforcement of such rate. This proposition requires no argument.

2. Assuming that the Court will find that under neither of the two schedules of rates promulgated by the Company will the estimated revenues, as found by the Court, be sufficient to yield the rate of return, as fixed by the Court, on the rate base as found by the Court, the Court should specifically adjudge,

(a) That the Company has the contract right to determine its own rate structure, including a service charge, provided only the rates and charges are just and reasonable;

(b) That the schedule of rates promulgated by the Company, including the service charge, are just and reasonable.

(c) That the impounded money be paid to the Company.'

3. Assuming that the Court should find the forty-five cent rate is too low, that both the first and second schedules promulgated by the Company are too high, *may the Court ascertain and fix the just and reasonable rates as of the contract date* and distribute the impounded moneys on the basis of such rates and charges?

We shall discuss the questions above suggested under the following propositions,

A. The Company has the contract right, as well as the statutory right, to declare its own rates and charges, and if such rates and charges are in fact just and reasonable the Railroad Commission has no power to disturb them.

B. That an injunction should issue restraining the Commission from entering any order denying the Company the right to make a service charge, or from charging a higher rate for a small quantity of gas, and lower rates for larger quantities.

C. That the rates and charges promulgated by the Company are in fact just and reasonable; *that such rates apply from the date of the contract;* that the impounded moneys should be ordered paid to the Company; that such rates are binding on the parties for a period of two years after the final judgment of the Court under the contract agreement.

D. That the question of just and reasonable rates and charges as of the contract date has been made by the parties a judicial question under the franchise agreement, and the Court may there-

fore, *independently of temporary rates or promulgated rates and charges, ascertain and fix the just and reasonable rates and charges as of the contract date;* that such judicially determined rates and charges become binding on the parties for two years after the date of the decree because of their agreement to that effect, and the impounded moneys should be distributed on the basis of the rates and charges as fixed by the Court."

Again the following at page 61:

"It is our contention that the Court may in the instant case judicially determine just and reasonable rates and charges as of the contract date, and that such rates and charges so fixed by the Court become binding on the parties for a future period of two years under the provisions of Section 7 of the franchise ordinance; and that such court fixation would be a judicial act and not a legislative act."

Again at pages 63 and 64:

"But even though both sides are fully agreed that they intended by the franchise contract to submit to the Court the final determination of the rate question, and that the Court should by its decision fix just and reasonable rates and charges as of the contract date, nevertheless it must be conceded that unless the Court shall construe the contract as in fact submitting this question to it for decision, and shall further conclude that such decision by the Court shall be the exercise of the judicial function, and not the attempted exercise of a legislative function, the Court may

properly decline to go further than to enjoin the enforcement of the forty-five-cent rate, *unless it shall also find either that the temporary rate of sixty cents will not produce an adequate return, and is therefore less than a just and reasonable rate, or shall find the Company rates will not yield an adequate return and are therefore at least just and reasonable, and in the event of either of said findings the impounded fund would belong and be ordered paid to the Company.*

That the parties have intended and attempted to agree that the Court should fix just and reasonable rates as of the contract date will, we believe, sufficiently appear from the contract, and this we shall now endeavor to show.

The contract clearly discloses the expectation of both sides that the Company would promulgate rates and charges *at least equal to or in excess of the highest temporary rate of sixty cents;* that the City would not accept such rates as satisfactory and would immediately file its complaint before the Commission, upon the filing of which the agreed temporary rates would at once apply, so that there would be no period of time when the Company rates would be collected, but that such rates would remain suspended until there should be a final determination of the rate controversy and a final fixation of rates either by the Commission, or by the court to which either of the parties might go as against the Commission rate, and *that the rates and charges as finally fixed by the Commission or Court should apply as of the contract date,* and the impounded fund distributed on the basis of such rates and charges."

We think it sufficiently clear from the foregoing that appellant's argument was in substance that the court should under all the evidence, in the light of the actual experience and results under the temporary rates, and the probable results under the Company's promulgated rates, fix just and reasonable rates for the gas service *as required by the franchise contract* and apply those rates to the contract date. We also think it clear that there is nothing in the portions of the company's brief quoted by the city which justifies the inference that the court was asked to determine the reasonableness of the Commission rate as of December 31, 1926, or to justify the inference that in determining the fair rates the court should disregard the cost of the Owsley County gas.

But to make this even clearer we invite attention to the following additional portions of the company's brief filed in the court below.

First, from pages 7 and 8:

> "During the negotiations for the new franchise strenuous objection was made to any substantial increase over the old rate of forty cents on the ground that the Company had for years, at times of extreme cold weather, when the gas was most needed, been unable to supply or deliver gas in such quantities, or at such pressure, as would supply the demand, causing much inconvenience and some hardship. In order to meet this complaint the Company *gave definite assurances* that *if granted a new franchise and adequate rate* it would be able to supply the peak demands in

cold weather *through an arrangement with the Petroleum Exploration Company*, which had recently developed a promising field in Owsley County, *to build an independent line to Lexington* and deliver gas to the Company at that point, *thus assuring the City of a supply of gas from two separate sources of supply, one through the new main to Menifee County, and from there on to Inez. It was stated at the time that the Company would have to pay forty cents for the Owsley gas* delivered at the Lexington gate. Being unwilling to rely entirely on the Company's assurance of its purpose to secure this Owsley County gas for Lexington, *the franchise ordinance was drawn so as to impose on the Company a contractual obligation to do so*, and while the City was willing to agree to a temporary rate of fifty cents until the rate question had been settled, it was unwilling to agree that the temporary rate should go to sixty cents until the gas from the Owsley field was actually delivered. This explains why the ordinance provides for the two temporary rates of fifty cents and sixty cents."

The accuracy of the foregoing statements was never questioned by the city, as will be seen from a reading of the city's brief in the court below (referred to later herein).

Then this from pages 10 and 11:

"For the purpose of this controversy the parties have directed their evidence of *values* to a date certain, namely, December 31, 1926, that being the nearest convenient and logical date to the

contract date. *The rates finally* to be *determined must relate back to the date of the contract, for two reasons, first, because this is pursuant to the franchise agreement; second, the Court has before it an impounded fund which may not be distributed, unless and until the Court shall find what rates are just and reasonable from and after the contract date.*"

A perusal of the city's brief in the court below will disclose that the correctness of the foregoing statement was not questioned.

And from page 37:

"The per cent returns are given in Kimball's Exhibit No. 5, the highest of course being under the 50-cent rate for 1926. That year however was quite abnormal in that the temperatures were much lower than the mean, thus greatly increasing the consumption of gas. Furthermore *this was prior to the contract made with Petroleum Exploration Company pursuant to the franchise requirement*—for gas to be delivered from the Owsley field at the Lexington gate and for which the Company pays 40 cents. *The cost of this gas greatly increases the operating expense and consequently greatly reduces the net revenues available for return. The net revenues therefore under the 40-cent and 50-cent rate for 1926, based on actual operations furnish no adequate guide or assistance in determining the probable revenues for the average year under either the first or second promulgated schedules, for in estimating such revenues it is obviously necessary to base such es-*

timates on normal or average weather conditions, and to make proper adjustments, among others, for the increased cost of gas."

The city never took issue with the above statement.

In view of the foregoing, is it possible that the excerpts from the company's brief quoted by the city is susceptible of the meaning now sought to be given them? Or that they support to the slightest extent the contention that "the parties" did in fact request the court to determine the income as of December 31, 1926, or to determine the validity of the Commission rate as of said date?

The appellant stands four square on everything stated in its brief filed in the court below. And by the same rule the city should be willing to stand on everything appearing in its brief filed in the court below, a copy of which is filed with this brief marked Appendix A. We quote the following from pages 7 and 8 of that brief:

"Cleared of all cloud, disregarding for the time what may be called the largely unimportant sidelines, the work of the court is to ascertain and apply from the record these simple fundamentals:

First. The value of the property of the Central Kentucky Company allocable to Lexington.

Second. *The company's proper and necessary annual expenses and charges, essential to its Lexington business.*

Third. *The rate at which it must sell its gas,* in order (a) *to take care of these annual expenses*

and charges, and (b) on top of them to earn a reasonable return on the ascertained value of the Company's property allocable to Lexington.

For the sake of emphasis and clarity let us restate this in another way:

The court is first to ascertain the value of the Gas Company's property allocable to Lexington. *It is next to ascertain the annual total of expenses necessary to run the business and keep up the property* and finally to find at what price the company must sell gas at Lexington *in order to pay these annual charges,* and to earn the company a fair rate on its ascertained values at Lexington."

Then this from pages 9 and 10:

"Next, with the illustration, we find *what the annual expenses and charges are.* We find them thus (see same Carter Ex. 7, pp. A 1, A 2, and A 4, and as revised):

* * * * * * *

Cost of 750,000,000 cu. ft. gas purchased (Owsley Co.) @ 40 cts. per M. $300,000.00

* * * * * * *

The foregoing calculation has been put in by us rather out of order, in the hope that it would serve as a map and guide for all that field into which this controversy brings us, to manifest that what we must get at is (a) the value of the property, (b) *the annual charges,* and (c) the price at which gas must be sold to *pay these charges* and a fair earning on this value."

And this from pages 33 and 34:

"(a) Upon an inspection of the Kimball table (his Exhibit 4, Sheet 14) it will be found that, outside of the United Fuel, not exceeding 10 cents was paid to any companies other than (1) the Kentucky Cities, (2) the Bed Rock, (3) the Petroleum Export (the Petroleum Exploration?), (4) the Hillsdale Company, and to Lewis Vincent. If we turn to the gas purchase contract exhibits, filed by the Central Kentucky in this record in response for a request that all of its gas purchasing contracts be filed, we find upon (1) the Kentucky Cities contract an endorsement that it has been cancelled. We find (2) a Bed Rock contract in the record. The price was originally 8 cents which seems to have been raised voluntarily to 12 cents. We find (3) no Petroleum Export contract in the record; *and if the Petroleum Exploration be meant, its contract for the 40-cent gas is taken care of upon the face of Mr. Carter's computations.* We find (4) the Hillsdale Gas Company contract in the record to provide for a maximum of 720,000,000 feet per annum, while as a matter of fact in the very second year of the contract it dropped below that amount (to 560,000,000); * * *

The result, therefore, is that the Central Kentucky is bound by contract to take not a foot of gas from any person or company *save the Owsley County gas* and possibly the Hillsdale; and as well it can supply (*save for the Petroleum Exploration* and possibly the Hillsdale contracts) every bit of the gas it sells directly from its own field, the United Fuel-Columbia-Central Kentucky gas wells

and fields. And buying gas elsewhere at 10 cents, it is hardly in position to contend either that its own gas is worth exceeding 12½ cents, or that it has the right to an income based upon any gas outlay (*other than the Owsley County gas*) in excess of ten cents per thousand."

And from pages 36 and 37:

"Second. *Mr. Carter allocated the high-priced Owsley County gas, just as he did all gas,* in these rate-of-return figures. The Central Kentucky intimates that because Lexington's franchise demanded the additional pipe line, *all the 40-cent gas coming through that line must be charged up to Lexington for rate-making purposes.* But here are the difficulties about that:

(a) The Owsley line interconnects with the company's main line just east of Lexington.

(b) The gas going into the line there must be an intermingled part of that flowing on beyond to Versailles, Frankfort and Georgetown.

(c) *The Mount Sterling franchise in the record demands the Owsley County gas, just precisely as does Lexington;* and that gas must be a commingled part of the Winchester, Paris, Cynthiana, and Mount Sterling supply."

Section 23 of the Mount Sterling franchise referred to appears in the record (R. 237). That section is identical with the same numbered section in the Lexington franchise, and as above shown was construed by the city as specifically *"demanding the Owsley County gas."*

It thus appears that both the city and the company agreed at all times that in the testing of the Commission rate, and of the company's promulgated rates; and in the fixation of reasonable rates, whether by the Commission or Court, full allowance should be made for the cost of the Owsley County gas. The city may not now contend that the Court below in determining a reasonable rate for the appellant's gas service was justified in not making full allowance for the cost of the Owsley gas. We quote the following apt and correct statement from the city's brief (page 43) filed herein:

> "That a party may not thereafter alter a position taken by him in a legal proceeding needs neither argument nor authority."

APPELLEES NOT ENTITLED TO FILE POINTS ON WHICH THEY INTEND TO RELY IN THIS COURT

The city's brief contains extended discussions of errors alleged to have been made against it by the court below notwithstanding it did not appeal. The city admits that the record brought here by it (appellee) on amortization and property values is incomplete. It contends that this is the fault of the appellant as the company had notice in the court below that the city intended to urge the alleged errors which it discusses in its brief filed in this Court, and that the appellant, if it desired additional portions of the record bearing on these matters, should have requested the incorporation thereof.

The first notice of the errors which the city intended to urge here in support of the decree below was the formal notice lodged with the Clerk of this Court and served upon the appellant after the record on appeal was filed. This notice consisted of a paper designated "Statement by the Appellees of the Points on which they Intend to Rely", which was filed with the Clerk on March ——, 1933. The Clerk was requested by the city to have the same included in the printed record. This request was refused by the Clerk because the Rules do not provide for the printing of a statement of points to be relied upon by an *appellee*.

The theory of the city appears to be that it may under the Rules, without taking an appeal, include in the Statement of Evidence such portions of the record which it desires bearing on errors alleged to have been made against it, the nature and character of which would at the time such amendment was offered be left entirely to be conjectured by the appellant. If such theory be correct, it would result in conferring upon an appellee the right to shape the record to be taken up by the appellant precisely as if a cross-appeal had been taken, and thus include perhaps a great amount of evidence in no way essential to the actual appeal.

It is argued that the appellant could have amplified the record so as to include such additional evidence as it might surmise would be needed in the discussion of unassigned errors which might be

urged by the appellee. There are several answers to this contention: first, there is no authority therefor under the Equity Rules, or under the Rules of this Court; second, the appellant, if it attempted to make further amendment to the Statement of Evidence, would be compelled to do so upon a mere conjecture as to what were the precise points or errors which the appellee might ultimately decide to urge in the Appellate Court; and third, the appellant would be thus forced to file a further amendment to the appellee's amendment to the Statement of Evidence without the latter being required to take an appeal or assign any errors.

Equity Rule 75 must be complied with, and provides that:

> "(b) The evidence to be included in the record, * * * shall be stated in simple and condensed form, *all parts not essential to the decision of the questions presented by the appeal being omitted* * * *. *The duty of so condensing* * * * *shall rest primarily on the appellant,* * * *. * * * the statement, together *with any objections made or amendments proposed* * * * shall be presented to the court * * *. When approved, it shall be filed * * * and become a part of the record *for the purpose of the appeal.*"

Equity Rule 76 requires that:

> "* * * care shall be taken * * * to exclude the formal and immaterial parts of all exhibits, * * *."

The appellant has complied with the requirements of the above Rules and with the provisions of Rule 10 of this Court. In *Newton v. Consolidated Gas Co.*, 258 U. S. 165, 174, it was said:

> "These rules were intended to protect the courts against useless, burdensome records, and litigants from unnecessary costs and delay. Counsel ought to comply with them, and trial courts should enforce performance of this plain duty."

Since the record brought here does not contain any portion of the appellant's evidence touching the alleged errors now complained of by the city, we do not feel called upon to follow the extended discussion, calculations and figures contained in the brief for the city on property values, amortization, etc. While there are quite a number of inaccuracies in the statements relative to what the evidence was or was not, and many calculations based on unwarranted assumptions, we do not deem it necessary or proper to discuss the same in the absence of the full record and of proper assignments of error.

DUE PROCESS

The earlier portion of the city's brief is devoted to a discussion of the proposition that whenever a Public Service Commission affords a "due process hearing", and fixes a rate for the service, there can be no Federal question by reason of the rate itself, and that a court of equity can not enjoin the enforcement of such rate unless it shall find the rate was fixed arbitrarily

and without proper evidence. That is, if it appears that the Commission granted a hearing and that the rate was not fixed arbitrarily or without evidence, the rate itself cannot be attacked as a violation of the Fourteenth Amendment even though such rate would result in depriving the utility of its property without just compensation.

This theory was pressed by counsel upon the court below and was rejected. It was fully and conclusively answered in the opinion of the court below on the question of jurisdiction, 37 Fed. (2d) 938. (R., pp. 61, 74). Some of the terminology in the city's brief might suggest the inference that the Railroad Commission, being a constitutional body, is vested with *judicial* powers and that its rate decisions are final and *res adjudicata*. The Kentucky Court of Appeals has held otherwise. In the case of *L. & N. Railroad Co.* v. *Greenbrier Distillery Co.*, 170 Ky. 775, at 785 and 786, 187 S. W. 296, the Court said:

> "The Railroad Commission, as an instrumentality of the government, was created in this state previous to the adoption of the present constitution by an act of the General Assembly. It was a creation of the legislative department of the government and so remained until the adoption of the present constitution, when, by section 209, of that instrument, it was made one of the permanent governmental agencies and was invested with such powers and duties as might be bestowed upon it by law, and until otherwise provided by law, it was granted such powers and jurisdiction, and was authorized to perform the same duties as it

was authorized by law to exercise and to perform at the time of the adoption of the constitution. Among other powers and jurisdiction it then possessed, was to render awards in favor of persons against the railroad companies for extortion. Act of April 6, 1882, as amended by act of March 7, 1890; I. C. R. R. Co. v. Paducah Brewery Co., *supra*. The power to make an award, however, as it is provided that the Railroad Commission shall make awards on account of extortion, *is not a judicial power, and in making an award it does not exercise judicial functions.* It is true that the statute provides, that upon a complaint of extortion it is made the duty of the commission to give the party of whom complaint is made, notice for ten days, and to hear such arguments, statements and evidence as may be offered, and if it finds that the rates complained of are extortionate, to fix a just and reasonable rate, and the carriers must not then charge more than the rate so established. This, however, is the exercise of a legislative power, and the duty of making investigation of the causes of complaint, as a basis upon which to rest the needed legislation, is no more the exercise of a judicial power than a legislative body exercises when it makes an investigation to determine the necessary and proper legislation to right any sore, which is upon the body politic.

* * * * * * * * *

When the commission makes a reparation award it does not *judicially determine anything. It gathers and preserves the evidence necessary upon which to base judicial action.* It collates the facts and sums up the results from the basis from which it acts, and this is presented to a *court for*

review, with ample opportunity for each party to have his day in court before the matter is determined alone by the court. The act of the commission in making a reparation award has no enforceable effect, until it is determined by the court, that its report of the results of its investigation is correct.

The Railroad Commission, in establishing a rate order, exercises a legislative power, which is delegated to it by the legislature, and its act, if done in accordance with law, is a valid and enforceable act of legislation. McChord v. L. & N. R. R. Co., 183 U. S. 483; C., N. O. & T. P. Ry. Co. v. Interstate Commerce Commission, 167 U. S. 479. Hence, a rate charged in excess of that fixed by the commission was unlawful and extortionate. Hence, the reasonableness or unreasonableness or confiscatory character of the rate order, or the arbitrary conduct of the commission in establishing it, was not, in the proceeding in the court below, a subject of inquiry. L. & N. R. R. Co. v. Garrett, 231 U. S. 229. It is not intended, by the foregoing, to say that the carrier is without remedy against a confiscatory rate prescribed by the legislature, *or a confiscatory or arbitrary rate order established by the Railroad Commission,* as the courts have the power to relieve against such injustice, but the act of legislation must be assailed by an action for that purpose, as by a suit in equity, in a court having jurisdiction, which can for once and for all determine its validity. St. Louis & S. F. R. Co. v. Gill, 156 U. S. 649; Chicago, M. & St. P. R. R. Co. v. Minnesota, 134 U. S. 418; L. & N. R. R. Co. v. Garrett, 231 U. S. 229."*

*Italics used in this brief are ours.

It is well settled that in order to constitute *due process* in cases of this character the utility must be afforded adequate opportunity for testing judicially an order of the Commission alleged to be confiscatory. As stated by this Court in *Ohio Valley Water Co.* v. *Ben Avon Borough*, 253 U. S. 287, 289: "In all such cases, if the owner claims confiscation of his property will result, the state must provide a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause, 14th Amendment."

THE EQUITABLE MAXIM

On page 61 of their brief the appellees say:

> "The exact application of the maxim here was, in the court's view, that fifty cents was enough; that any less would not be enough, and that any more would be too much; and the court's opinion and decree worked out a calculation arriving at that result. * * * Under the authorities it particularly is within the province of courts of equity to grant injunctions on condition."

We set forth the facts and authorities justifying and requiring the granting of a permanent injunction in this case at pages 68 to 76 of our original brief. In addition to the cases there cited we invite attention to two others in support of appellant's contention that the trial court erred in refusing to enjoin the Commis-

sion rate unless the company agreed to accept the rate fixed by the court. In *St. Louis, I. M. & S. Ry. Co.* v. *Bellamy,* 211 Fed. 172, the court said:

> *"There can be no doubt that the court in granting an injunction has the power to impose reasonable conditions, as the writ of injunction is not a writ of right but one of discretion; but that does not mean an arbitrary discretion, dependent solely on the whim of the chancellor. It means a sound, judicial discretion, informed and directed by the established principles, rules, and practice of equity jurisprudence. This question was fully discussed in the opinion filed in this case in 168 Fed. 720, where many authorities are cited. To grant an injunction upon such conditions that the party asking it waive its defense and concede its liability, when that liability is one of the main questions in issue, would be a travesty on justice and as much a deprivation of its property without due process of law as was the act condemned in Hovey* v. *Elliott, 167 U. S. 409, 17 Sup. Ct. 841, 42 L. Ed. 215. Of what benefit is the injunction to the complainant if at the same time it must, in effect, pledge itself to confess judgment?"*

While there are cases supporting the imposition of terms in the granting of a preliminary injunction, we have found no case holding that when a rate order is held to be confiscatory the court may impose conditions in granting a permanent injunction. The distinction is pointed out in *In Re Arkansas Railroad Rates,* 168 Fed. 720, at pages 723-724. We quote:

"From these authorities it may be stated that a court when called upon to grant a preliminary injunction, may impose such terms, on granting it, as will protect the rights of the defendant as well as those of the complaining party, and if, after the temporary injunction has been granted, and before a final hearing, while it is in force, it is shown to the court that great injustice is being done by reason thereof, that the acts of the plaintiff are unjust, oppressive, and unmindful of the rights of the defendants, the court may modify it by imposing terms which will prevent such injustice.

This leaves for determination another very important matter. Can the court, for the purpose of requiring the complainant, who obtained the preliminary injunction, to do equity and preventing the imposition of extortionate rates for the carriage of freight and passengers, fix maximum rates beyond which complainants must not go during the pendency of the litigation, and make a compliance with these rates a condition upon which the temporary injunction will be continued? * * * Upon final hearing the court must, if it is shown that the commission rates are compensatory within the meaning of the law, dissolve the preliminary injunction *or make it perpetual if they are found to be non-compensatory, and therefore confiscatory. The authorities are not only numerous, but harmonious, on this subject.* A few of the leading and late cases is all that it is necessary to cite on the subject. Reagan v. Farmers' Loan & Trust Co., 154 U. S. 362, 400, 14 Sup. Ct. 1047, 1054, 38 L. Ed. 1014; Interstate Commerce

Commission v. Ry. Co., 167 U. S. 479, 499, 505, 17 Sup. Ct. 896, 42 L. Ed. 243; Prentiss v. Atlantic Coast Line, 211 U. S. 210, 226, 29 Sup. Ct. 67, 53 L. Ed. .... But when the application is for a temporary injunction, the rule is different."

COMPANY'S PROMULGATED RATE

In questioning appellant's contention that it has both the contract and statutory right to fix its own rates or rate structure the city makes reference to the "service" or customer charge of 75 cents contained in the company's second schedule. A word of explanation is perhaps necessary in order to avoid misunderstanding on this matter. The rates promulgated by the company pursuant to the franchise contract (Sec. 4B) (R. 32), are the rates appearing in this record (R. 110). During the progress of the hearing the company filed a second schedule which it has abandoned. Therefore the discussion in the city's brief relative to the "service" or "customer" charge contained in the so-called second schedule needs no response.

The appellant in its main brief does not contend for the validity of any specific customer, service, or minimum charge. It merely claims the right under its franchise contract and the statute to promulgate its own schedule of rates, and that such schedule may properly contain a minimum and/or service charge, and higher rates for smaller quantities of gas and lower rates for larger quantities, provided the net

revenue resulting from such rate schedule does not exceed a fair return.

SEQUENCE OF EVENTS

At page 44 of the city's brief is set out the sequence in point of time of certain events and reference is made to conditions or conditions subsequent. The employment of the phrase "condition subsequent" is inapt if it is intended to have any special significance as bearing on appellant's contract rights.

While the coming in of the Owsley County gas is an event occurring subsequent to the contract, it is not a condition subsequent. It is in fact the performance of a condition precedent by reason of which arose the right of the company to demand and the obligation of the city and other consumers to pay reasonable rates based on the performanec of such requirement.

At the time the company promulgated its first schedule its obligations under Section 23 was fixed, and it was known that in the performance thereof it would be required to contract for the Owsley County gas and to pay therefor 40 cents per M. c. f. As stated in the brief filed for the city in the court below: "The Mt. Sterling franchise * * * *demands the Owsley County gas, just precisely as does Lexington;* * * *."

The contract with the Petroleum Exploration was entered into on March 24, 1927 (R. 178). This was in compliance with the company's obligation under the franchise contract (R. 36). The day *after* the Petroleum Exploration contract was made, to-wit, on March

25, 1927, the city filed its complaint with the Railroad Commission.

The rates promulgated by the company, averaging 60 cents, were prescribed in anticipation of and based upon the company's obligation under Section 23 to acquire the Owsley County gas, and are equivalent to the temporary rate fixed by the Franchise Contract.

If the rate controversy could have been heard and the evidence presented on the day following the filing of the city's complaint before the Commission, that body would have had before it all of the evidence necessary to enable it to determine what rates would be reasonable based on the Petroleum Exploration contract. In other words, it would then have been able to estimate probable revenues and expenses under the company's rates, making proper allowance for the minimum cost of the Owsley County gas.

Nor was the intercorporate relation which arose as of January 1, 1928, a "condition subsequent." It was merely a subsequent occurrence. If it had been possible for the evidence to be presented to the Railroad Commission and the rates determined at any time during the year 1927, such rates would necessarily have been fixed without reference to the subsequently occurring intercorporate relation.

Finally, and in confirmation of appellant's contention that the controversy has always been understood to be the fixation of just and reasonable rates under the conditions that brought into effect the 60-cent temporary rate, namely, the furnishing of the Owsley

County gas through the second pipe line; and that such rates should be applied from and after the franchise contract date, we call attention to paragraph "Fourth" of the Commission rate order (R. 13) and particularly the following language of the Commission:

> "That it is provided in Section 4(E) * * * that pending the final determination * * * the * * * Company shall * * * charge * * * sixty (60) cents * * * for its gas;"

The Court will note that no reference is made by the Commission to the 50-cent temporary rate which had continued for only a few months. Is it not clear that the Commission understood—just as the parties understood—that the rates to be fixed were to be under the "60-cent" conditions, and should be applied to the franchise contract date and be effective for the prescribed period after that date? This was precisely what the Commission did. It is what the Statutory Court attempted to do, but did incorrectly, and then refused to correct its mistake.

It would unduly prolong this discussion and serve no useful purpose for us to follow through the long arguments contained in the city's brief and reply thereto point by point. The brief is replete with statements for which there is no foundation whatever in the record or in fact. Numerous excursions far afield are taken and pages of discussion which lead nowhere. By the assumption of unwarranted premises and even assuming the point in issue, the discussion of general

principles without relation to the facts of this case, and repetition, counsel evidently seek to persuade the court to their point of view, perhaps on the basis of their remark at the bottom of page 106 that "A thought, an idea, however dogmatic, repeated and repeated, finally tends to become accepted as true." However, in limiting the scope of this reply appellant does not accept, as either relevant or accurate, statements of fact and conclusions in the city's brief not commented on herein.

THIS CASE SHOULD BE FINALLY DISPOSED OF

In conclusion appellant earnestly insists there can be no doubt about its right to reasonable rates under the law and the franchise contract, and that it would be the grossest injustice not to allow for the cost of the Owsley County gas in fixing reasonable rates. Appellant's estimate of return under its schedule of rates is conservative, is absolutely unchallenged by contrary proof, and conclusively shows that the promulgated rates will yield a return of only 5.42% on the low rate base fixed by the Statutory Court. An examination of the record covering operating expenses will lead to the conclusion, to adopt the language of this court in *Ohio Utilities Co.* v. *Public Utilities Com.*, 267 U. S. 359, 363, that there is no evidence which "casts doubt upon their fairness as a measure of the necessary annual operating expenses."

The observation in the opinion in *Lincoln Gas Company* v. *Lincoln*, 250 U. S. 256, 262, that this "litiga-

tion has been extremely tedious and burdensome to both sides and it ought now to be brought to a conclusion on the record as it stands," is sharply applicable to this case. As all facts necessary to a proper disposition of the case are before this Court we urge that rather than prolong the litigation by remand for further findings it now decree the company's promulgated rates to be reasonable (even lower than justified) and end this rate proceeding.

Respectfully submitted,

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Lexington, Kentucky,
May 6, 1933.